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**THE MICHIGAN DEPARTMENT
OF ENVIRONMENTAL QUALITY**

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THE MICHIGAN MUNICIPAL BOND AUTHORITY

Janet Hunter-Moore, Executive Director

**Under the Authority of Part 53, Clean Water Assistance, of the Natural Resources
and Environmental Protection Act, 1994 PA 451 and the Shared Credit Ratings Act, 1985 PA 227**

Present the

**FISCAL YEAR 2001 ANNUAL REPORT
of the MICHIGAN STATE REVOLVING FUND**

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Prepared: January 2002**

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CHARTS

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I. INTRODUCTION

This Fiscal Year (FY) 2001 Annual Report is submitted to the United States Environmental Protection Agency (EPA) in compliance with Sec. 602(b)(10) and Sec. 606(d) of the Federal Water Pollution Control Act, P.L.92-500, as amended. It covers the period from October 1, 2000 to September 30, 2001, highlighting the activities of Michigan's State Revolving Fund (SRF) loan program.

The Michigan Department of Environmental Quality (MDEQ) is the lead agency for this program. The Municipal Facilities Section of the Environmental Assistance Division (EAD) continues to serve as the MDEQ's program administrators for the SRF.

The MDEQ and the Michigan Municipal Bond Authority (MMBA) jointly administer this program under the authority of Part 53, Clean Water Assistance, of the Natural Resources and Environmental Protection Act, 1994 PA 451, and 1985 PA 227, the Shared Credit Ratings Act, as amended. The state also conducts its SRF in a manner consistent with requirements established in the federal Water Pollution Control Act (P.L.92-500, as amended) and federal regulation.

We offer this comprehensive public report to detail the activities undertaken to reach the objectives set forth in the Final FY2001 Intended Use Plan (IUP). This annual report is submitted to EPA and is available as a read-only file through the Home Page found on the Internet. The Internet address is <http://www.deq.state.mi.us/ead/mfsect>.

II. CAPITALIZATION OF THE SRF

During FY2001, Michigan received a federal grant of \$56,907,240. The state is required to provide a 20 percent match for each federal dollar contributed to capitalize the SRF. To match the FY2001 federal grant, Michigan provided \$11,381,440. The source of this match was derived from state general fund appropriations. In addition to the federal and state capital contributions, the SRF is also capitalized with principal and interest payments from earlier loans, account earnings and released funds from debt service reserve accounts.

III. PROGRAM ISSUES

Binding commitments made during FY2001 were awarded with an interest rate of 2.5 percent. Repayments are amortized over 20 years with approximately level debt service. One project used loan proceeds to refinance existing debt and there were no loan guarantees during FY2001. All commitments were made to qualified Section 212 projects.

For FY2001, projects for qualified Section 212 uses were drawn from the FY2001 Project Priority List administered under provisions set forth in Part 53, Clean Water Assistance, of the Natural Resources and Environmental Protection Act, 1994 PA 451, and its accompanying administrative rules. A copy of this list was submitted to the EPA prior to the start of FY2001.

The MDEQ continues to promote the SRF in local community meetings, through dissemination of the SRF brochure and guidance documents, through The Loan Arranger, through the MDEQ website, and through participation in various public forums. Staff has at its disposal, a computerized presentation in Microsoft PowerPoint explaining the SRF. This presentation is targeted toward local community groups and can be tailored to a specific audience by adding, deleting, or editing the slides. The presentation is available in three separate media; slides, overheads, and a diskette and is also available for download through the EAD website.

IV. GOALS AND ACCOMPLISHMENTS

A. Short-Term Goals and Accomplishments

Michigan's IUP described short-term goals to be implemented during FY2001. They were:

1. Identify and integrate outreach efforts on pollution prevention activities.

This is a continual process involving staff and management effort.

2. Implement the Small Community Hardship Assistance Program.

Michigan has continued to look for opportunities to provide assistance to small communities in hardship situations. One of the stumbling blocks to implementation of any type of hardship assistance program to accommodate the available federal money is that most communities in Michigan are already sewered. So Michigan executed a partnership agreement with the U.S. Department of Agriculture, Rural Development in July 2000 which established a mechanism to award hardship grant assistance to projects proceeding through Rural Development's Water and Waste Disposal Direct and Guaranteed Loan/Grant Program. The first obligation was made in November 2000 and when combined with two subsequent obligations, brings total assistance for the fiscal year to \$1,922,000.

3. To fund those projects identified on the Project Priority List.

One project was funded in the first quarter for \$20,670,000. In the second quarter, four projects were funded totaling \$63,570,000; one project was funded in the third quarter and four projects in the fourth quarter totaling \$82,200,000 and \$89,175,000, respectively. For the full fiscal year, the MDEQ and the MMBA committed \$255,615,000 to ten projects, bringing the total commitments made from inception of the SRF to \$1,525,005,000.

4. Work with other agencies in developing integrated approaches to watershed management efforts.

Other than those activities described in Section IV, B, 1, no further activity is occurring in this area.

5. Coordinate disbursement practices with the DEQ's Office of Financial Services.

Work continues in coordinating and improving the disbursement practices.

B. Long-Term Goals and Accomplishments

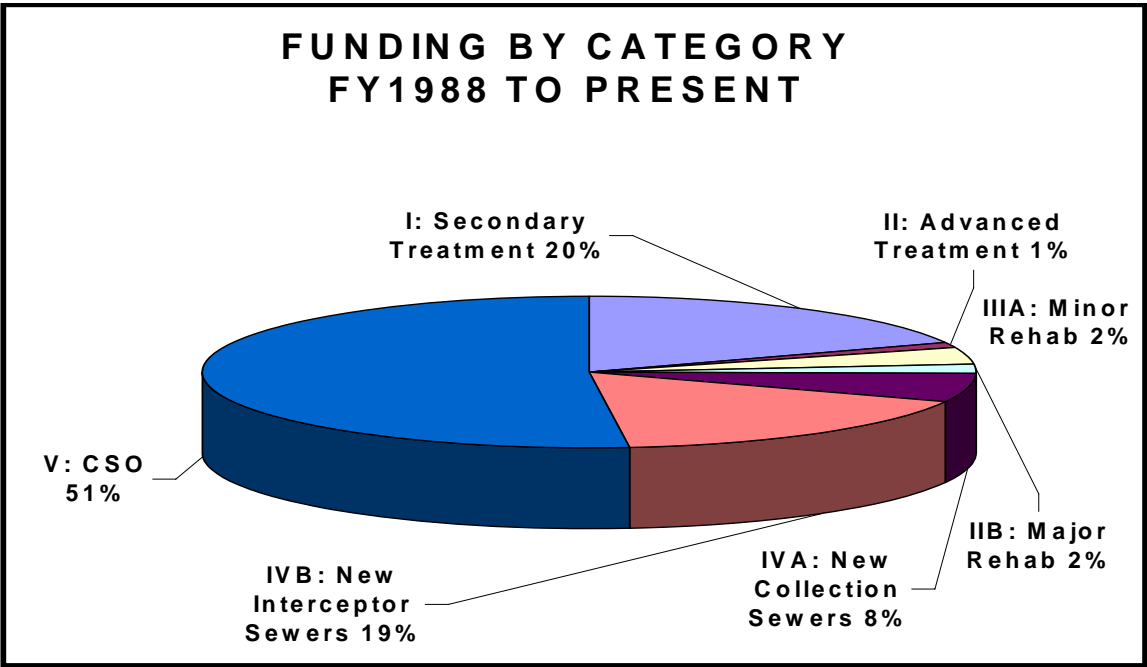
Michigan's IUP also included long-term goals that would be addressed by the SRF. They were:

1. To achieve and maintain statewide compliance with all applicable State and Federal laws, rules, and standards.

The SRF is a major inducement for local municipalities to cooperate and voluntarily seek to achieve compliance with state and federal laws and water quality standards. The MDEQ maintains a core belief that achievement of pollution prevention is far more effective if potential projects are examined to ensure compliance with water quality standards, while also meeting criteria to establish the solution as the cost-effective alternative in order to protect the viability of the SRF.

In past years, Michigan's SRF program has provided substantial assistance in funding

towards combined sewer overflow (CSO) abatement efforts. The state has funded sizable projects in Grand Rapids, Lansing, and Saginaw. While over the life of the SRF, 52 cents of every dollar loaned has been used for correction of CSO problems, there is still work to finish. The SRF will continue to fund necessary CSO projects as they arise and it is anticipated that Phase II Rouge River projects, as well as those from the city of Detroit, will seek assistance over the next few years. Following is a chart displaying the types of projects funded by the SRF. Chart 1 is a detailed list of projects funded by category.



In addition, Michigan has undertaken an initiative to identify sanitary sewer overflows (SSO), and the SRF will play a role in addressing solutions to the many SSO problems that are coming to light.

2. To protect the public health and environmental quality of our state.

Inherent within the SRF program is our resolve to first protect the public’s health and welfare. Our priority system is structured to give greatest weight to problems that most impact the health of Michigan’s citizens and the environmental integrity of our state.

The state’s Project Priority List establishes the list of fundable projects for each fiscal year. Projects are ranked using a number of criteria, most notably outstanding enforcement action that exists for proposed projects. Michigan places a high priority on resolving those situations where enforcement action is involved and, accordingly, any enforcement action against a community plays a crucial role in establishing that community’s position in the fundable range. Many projects in the fundable range are involved in an enforcement action of some type.

3. To further integrate principles of watershed management and water quality restoration within urban, as well as outstate areas.

One of the MDEQ's major initiatives is the redevelopment of urban brownfield areas in hopes of preventing the continued loss of open farmlands. Whenever an urban project has scored high enough in priority, the SRF has sought to provide financial assistance to improve the water quality of the project area.

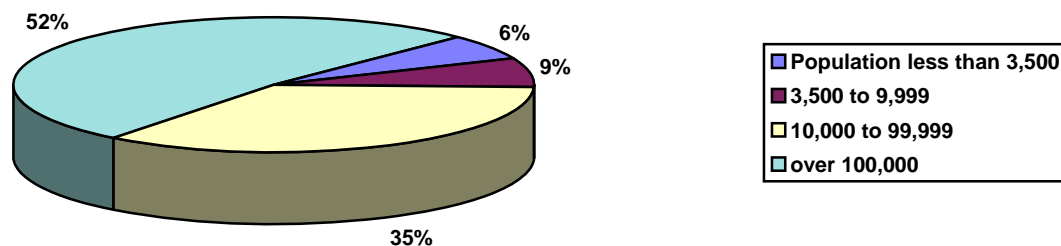
We have already sought to incorporate watershed sensitivity into our project management. Good examples are the commitments to Lansing, East Lansing, Grand Ledge, and Grand Rapids for their CSO strategies that reduce pollutant loadings in the Grand River watershed. Our continuing efforts to work with communities in the Rouge River and Lake St. Clair watersheds in addressing their needs also reflects our commitment to watershed management.

While the SRF has funded substantial projects in outstate Michigan, it has contributed substantial assistance to urban communities such as Lansing, Grand Rapids, Detroit, Wayne County, Saginaw, and communities tributary to Lake St. Clair, to address major needs within each. Of the total SRF loan dollars distributed to date, 52 percent has been awarded to projects with service areas where population is in excess of 100,000.

The accompanying charts document the progress made since the inception of the program. Michigan's commitment to small communities remains equally strong. Of the ten projects funded this year, two projects representing \$7,485,000 in construction costs were for communities with a population less than 10,000. Over the life of the SRF, a total of 65 loans, or 35 percent of loans made, were issued to communities with population less than 10,000. In dollar volume, \$205,825,000, or 14 percent of total binding commitments went to these smaller communities. To date, the numerical distribution of SRF loans is as follows:

Population less than 3,500	\$ 94,045,000
3,500 to 9,999	\$ 111,780,000
10,000 to 99,999	\$ 530,220,000
<u>over 100,000</u>	<u>\$ 788,960,000</u>
TOTAL LOANS	\$1,525,005,000

Number of Projects Sorted by Population



4. To secure Michigan's full share of federal funding available under Title VI and to expeditiously obligate these moneys, along with state contributions, for the construction of water pollution control activities that meet state and federal requirements.

The SRF has applied for and received all available capitalization grants through FY2001's federal appropriation. These funds are being committed to local units of government in an

expeditious manner.

5. To develop strategies within the SRF to assist smaller, hardship communities in meeting water quality standards.

Municipal Facilities Section staff, as well as district staff of the Surface Water Quality Division and Waste Management Division, continually meet with local governmental officials to discuss wastewater management problems and potential solutions. Special efforts are expended to work with small, often rural, communities who face wastewater problems that will likely involve capital expenditures to resolve. By involving staff of the Rural Community Assistance Program (RCAP) and staff of the Office of Rural Development, efforts are undertaken to address the unique situations that hardship communities face.

V. DETAILS OF ACCOMPLISHMENTS

A. Fund Financial Status

1. Binding Commitments: The SRF made ten binding commitments to Section 212 projects during the fiscal year. The state's commitments are made in the form of Orders of Approval issued by the Chief of the EAD on behalf of the MDEQ. Chart 2 (Funded SRF Projects to Date) provides a complete, chronological list of all projects assisted by the SRF to date. During FY2001, \$255,615,000 was committed for project assistance. The total cumulative binding commitments to communities equal \$1.525 billion as of September 30, 2001.
2. Capitalization Grants: The Michigan Water Pollution Control Revolving Loan Fund was awarded a capitalization grant of \$57,195,369 from FY2001 federal funds. This amount was matched by the state with an \$11,439,074 contribution from general fund appropriations. Loans were awarded from these funds and included the remaining uncommitted balances from earlier awards, investment earnings and repayments of earlier loans.
3. Disbursements: Loan disbursements of \$192,505,343 were made during FY2001, bringing the total during the program's life to \$1,166,569,761. Administrative expenses accrued in FY2001 were \$1,818,230.
4. Audit Report: An audit of MMBA's financial records for the SRF will be forwarded upon completion in the near future. Unaudited financial records will be sent under separate cover from the MMBA. The audit conducted by Plante and Moran during FY2001 found that the SRF program financial statements present fairly, in all material respects, the financial position of the program and the results of operations and cash flows for FY2001 are in conformity with accounting principles generally accepted in the USA.

We believe these financial statements reflect the condition of Michigan's SRF and underscore the sound management necessary to ensure the health of the fund in relation to its goals and objectives. Michigan has fulfilled requirements found at 40 CFR 3135(h) by establishing fiscal controls and accounting procedures to assure proper accounting for payments received by the SRF, disbursements made by the SRF, and SRF balances.

5. Credit Risk of the SRF: Michigan undertakes an exhaustive review of each applicant's credit-worthiness. This review examines the financial health of the community and its primary commercial and industrial base. The resulting approval of each applicant provides a sound basis for awarding assistance to only those communities possessing the ability to repay the loan.

No assistance is offered to any community that is unable to demonstrate an investment grade credit. If a community cannot demonstrate a minimum investment grade credit, we expect them to seek credit enhancement or finance through another governmental agency (such as the county). This must be done in order to secure their credit position before the Order of Approval can be written. Michigan's SRF has never suffered a payment default from any municipality.

B. Assistance Activity

Loan assistance through the MMBA was awarded to each of the municipalities that received an Order of Approval from the MDEQ. No other qualified uses of the funds were made other than project and administrative funding.

C. Provisions of the Operating Agreement/Conditions of the Grant

The state of Michigan agreed to a number of conditions in the Operating and/or Capitalization Grant Agreement. These conditions are described below:

1. Provide a State Match: The Michigan Legislature appropriated the amount necessary for the 20 percent FY2001 state match. In addition, Michigan has historically provided state match funds from a variety of eligible sources including issuing state match bonds. For FY2001, the amount from the state General Fund was deposited in full to the SRF accounts. The MMBA administers the match account as part of their overall financial management.
2. Binding Commitments: The state entered into ten binding commitments to provide assistance from the SRF to local municipalities. By the act of offering these commitments during FY2001, Michigan continues to exceed the requirement for obligation of 120 percent of the federal award amount within one year.

Additionally, we account for \$1,818,230 in actual administrative expenses, which are also applied against the state's binding commitment requirement. The EPA allows the state to account for the full 4 percent of the federal capitalization grants to be applied against binding commitments at the time of each grant award. Michigan has chosen to account for actual administrative expenses against binding commitments for programmatic reasons.

3. Expeditious and Timely Expenditure of Available Funds: The EPA annually reviews the reimbursement process used by the MDEQ and the MMBA to ensure that payments to municipalities are made in a timely and expeditious manner. In most instances, a wire transfer occurs within ten days of receipt of a request for reimbursement from the local unit of government. During site visits, the EPA has affirmed Michigan's sustained ability to turn payment requests around quickly. The local communities and the contractors know that we will expeditiously handle this important task, ensuring no delays in the flow of funds to the project. Documents upon which this assessment is based are available for inspection at the MDEQ and the MMBA offices.

The federal share is provided through the federal Automated Clearinghouse. State funds are drawn simultaneously with the federal funds during this time. The draw method used in Michigan satisfies our state requirements to provide a state match prior to, or at the time of, the federal draw on the Automated Clearinghouse system. To date, Michigan's SRF has committed \$1.525 billion in project loans.

4. Amendments to the IUP: The Final IUP and Project Priority List for FY2001 were previously submitted to the EPA. No amendments were made to either document.

5. Minority and Women's Business Enterprises: In order to meet federal initiatives, the state of Michigan agreed to an overall fair-share objective for FY2001 of 4 percent for Minority Business Enterprise (MBE) and 4 percent for Women's Business Enterprise (WBE). In its attempt to meet this objective, the state advised all potential applicants for SRF loans of this commitment. In addition, the state included a reporting requirement as a special condition in all supplemental agreements executed between the loan recipient, the MDEQ, and the MMBA.

As part of the state's continuing effort to meet the MBE/WBE objective, presentations are made at the pre-bid meetings to explain the federal requirements to potential contractors, subcontractors, and suppliers. Compliance with the loanee's reporting requirements has shown that the state of Michigan has not met its MBE objective for FY2001 with an actual participation of 3 percent for MBEs and 2 percent for WBEs. Participation rates are low due to lengthy procurement processes for some loanees. Full reporting is expected to increase the participation levels. These figures were reported by Ms. Karen Jurgensen, Office of Financial Services, MDEQ, as part of the state's required submission during the fourth quarter of FY2001.

6. Other Federal Authorities: The state of Michigan requires each municipality to comply with all applicable federal crosscutting authorities and stipulates that the authorized representative so certify in the application. The Application for Assistance sets forth municipal requirements for compliance with federal cross-cutters.

We seek up-front coordination by involving a wide range of agencies in the Finding of No Significant Impact (FNSI) process when drafting the Environmental Assessment. These federal, state, and local agencies are given the chance to add input to the project and comment on any crosscutting issues.

Environmental cross-cutters are typically addressed during review and approval of a project plan. Activities conducted by MDEQ staff are presented in the Project Planning/ Environmental Assessment chapter of our SRF procedures manual.

Cross-cutting issues relating to social legislation are dealt with prior to the loan award through applicant certifications mentioned earlier and through follow-up reporting, such as in the case of MBE/WBE requirements.

Our staff procedures manual outlines the appropriate response in the event cross-cutting issues arise. When warranted, we coordinate contacts with appropriate agencies. If necessary, the state will seek assistance from the EPA for help with other federal offices.

7. State Environmental Review Process: The ten communities receiving assistance during FY2001 were reviewed and approved using the state's environmental review procedures. It was determined that no Environmental Impact Statements were necessary for any of these projects. Instead, an Environmental Assessment was prepared and a FNSI was issued for each project.
8. Consistency with Planning: No project plan in the state of Michigan can be approved without sign-off from the appropriate 208 planning agency, which documents the submittal is consistent with regional planning. The necessary review/concurrence was received in each instance.

Section 205(j) and 303(e) requirements are administered separately from the SRF by various

sections of the MDEQ Surface Water Quality Division. Grants have been made to several local and regional entities to carry out water quality management planning. Section 303(e) requirements are satisfied via our state permitting process. In order to continue Michigan's delegated permit writing program, the state must comply with Section 303(e).

Prior to receiving the first capitalization grant, this office verified the existence of an approved planning process. The EPA's continued recognition of our delegation is proof that we remain in compliance.

9. Cash Disbursements: Disbursement procedures are executed in conjunction with the MMBA. The MDEQ receives requests for disbursements from the local municipalities. We review them for content and accuracy and then transmit them simultaneously to the MMBA and the MDEQ's Office of Financial Services. The respective offices will process a request to draw on the federal Automated Clearinghouse system in accordance with 40 CFR 35.3135(b)(1). Once in the SRF account, the MMBA processes a wire transfer of funds to the local municipality.
10. Administration of the SRF: The MDEQ has agreed to administer the SRF in accordance with its application, IUP, and the Operating Agreement. In doing so, certain administrative procedures are implicit. The operation of the fund is bound by the following provisions:
 - agreement to accept payments
 - state laws, rules, and procedures
 - state accounting and auditing procedures
 - recipient accounting and auditing procedures
 - use of the Automated Clearinghouse federal payment system
 - repayment
 - annual audit requirements
 - annual report
 - annual review

To the extent of any conflict amongst these documents, the MDEQ further agreed that terms of the Grant Agreement will prevail.

11. Automated Clearinghouse: Michigan has agreed to accept payment from the EPA through the Automated Clearinghouse system and has abided by cash draw rules.
12. Legal Certifications: The state of Michigan has provided all necessary certifications from the state Attorney General's office, which attest to its ability to implement the SRF and bind itself to the terms of the Capitalization Grant Agreement.

VI. SIGNIFICANT PROJECT ACCOMPLISHMENTS OF THE SRF

Over the lifetime of the Michigan SRF program, the dependence on federal dollars for capital funds has diminished to a point where the dollars capitalized through principal, interest, and investment exceeds those dollars received from the EPA Capitalization Grant. This shift from federal funds to SRF generated funds for financing SRF projects is a testament to the philosophy of the revolving fund concept. Michigan, through its efforts to maximize initial funding opportunities and in turn, loan those funds out, has created a viable revolving fund mechanism.

The interest rate for projects funded during the first five years was 2 percent. For FY1995-1998 the rate increased to 2.25 percent, and since FY1999, the rate has been 2.5 percent.

To date, Michigan's SRF has gone to the market for ten issues. The most recent was in September 2001 for \$222,800,000. These bonds are used to provide disbursement proceeds for project draws and are timed to cover a period running from 12 to 18 months.

Both the SRF and the DWRP 2001 Revenue Bonds received the highest ratings from Fitch (AAA), Moody's Investor Services (Aaa), and Standard & Poor's (AAA). These ratings demonstrate a high level of confidence in the structure and administration of Michigan's infrastructure programs.

VII. CONCLUSIONS

Michigan's SRF program has matured into a well run, well received financing program. The state has been able to deliver its available funds in a manner that emphasizes consistency of environmental review, financial capability standards, as well as delivery of reimbursement for project costs. There have been 184 projects funded to date, totaling \$1,525,005,000 in loans. The moneys which capitalize the SRF are now derived predominately from repayments and earnings on investments. The original intention of developing the SRF as a revolving, self-supporting fund is now being realized.

The Municipal Facilities Section has continued to effectively manage the SRF program for water pollution control, while proceeding with a successful DWRP program. Additional staff have been trained and integrated into the existing staff. The Municipal Facilities Section is responsible for both DWRP and SRF projects, and works diligently to ensure that projects in both programs receive full attention. The Municipal Facilities Section remains committed to customer service and through shared experiences and customer feedback, revisions and improvements to both programs are implemented on a periodic basis. We believe that the staff commitment to each program is the principal reason that Michigan's revolving fund programs will continue into the future with high visibility and success.